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Memo

To: BusinessNZ membership

From: John Pask/Steve Summers

Date: 21 May 2015

Subject: **Budget Summary 2015 – A plan that's working**

Action Required: For information

Budget 2015 – Key Issues and Outcomes

Background

The Budget 2015 largely lived up to expectations as a no frills budget, aptly titled "A plan that's working". Most initiatives were pre-announced in the weeks and days leading up the Budget event itself. In some respects this represents a much more mature approach to the Budget process itself, in that the days of 'big bang' Budget announcements without clearly thinking through the consequences are largely over.

The Budget reflected both the domestic and international economic realities New Zealand currently finds itself in. Certainly, the Government resisted the temptation to achieve a Budget surplus at all costs, although the deficit outlined in the Budget is trivial in the context of the bigger picture.

An investment focus in respect to both business and social policy issues will pay dividends down the track. A focus on a hand up, rather than a handout, is key towards ensuring as many New Zealanders as possible can participate in work and in positively contributing to New Zealand society.

At the centre of the budget is a $790million package to reduce hardship among children in New Zealand's poorest families. Within this package, announcements relating to the labour market include both incentives and sanctions that will best target those most in need.

Fiscal priorities

The Government has stated five fiscal priorities:

- Returning to surplus this year and maintaining surpluses in the future
- Reducing net debt to 20 percent of GDP by 2020, including repaying debt in dollar terms in 2017/18
- Further reducing ACC levies
- Beginning to reduce income taxes from 2017
- Using any further fiscal headroom to reduce debt faster.

The following outlines in more detail what the key announcements are that are relevant to business, including BusinessNZ's thoughts and reactions where appropriate.

ACC levy changes

The Budget has focused on carrots and sticks. On the carrot side of the equation it is very pleasing that the Government has announced a proposed cut in Accident Compensation (ACC) levies of around $500 million. This effectively represents a tax cut for businesses, earners and motor vehicle owners. Perhaps more important is the introduction of the new ACC Financial Responsibility and Transparency Amendment Bill. This will ensure that levies reflect sound insurance principles and is a major breakthrough towards ensuring public trust in ACC is maintained and the Government of the day is held to account.

The Government has taken an investment approach to areas requiring greater funding, such as child poverty and housing, along with the business as usual increases in education and health care expenditure.

Housing

On the other side of the equation, the Government has tightened rules around the purchasing and sale of property to try and ensure capital gains are taxed if property is bought and sold within two years (with certain exemptions e.g. the family home).

While some might consider this simply puts a degree of clarity around current rules to some extent (i.e. houses and shares bought for the specific purpose of trading are subject to tax currently), the two-year principle could have unintended consequences. For example, it could see even fewer houses put on the market as individuals try and avoid the new tax, in turn resulting in even higher house prices.

Perhaps equally, or even more importantly when designing tax policy, is the need to understand what the tax policy is trying to achieve – i.e. what is the specific problem? If the intention is to generate more revenue, the policy should be assessed alongside other tax raising initiatives and/or reducing expenditure. If the policy is to slow growth in Auckland housing prices, then it is important to understand what is driving the increases and address those issues as directly as possible.

In terms of housing, the key issue is still principally land supply and availability to meet demand and to some extent the announcement by Government to free-up more Crown-owned land for new housing in Auckland is a little step in the right direction. Until this problem is addressed, other policies such as taxing capital gains and the Reserve Bank's recent decision to restrict investors from purchasing housing unless they have a 30% deposit are simply applying band-aids to a major wound. While it could be argued to every little bit helps, there will be unintended consequences with such policies, as outlined above.

Taxation policy

Talking of tax policy, the Government, as expected, has signalled potential future income tax reductions from 2017, but with the expected caveat as fiscal conditions permit. While clearly signalling tax cuts will whet the appetite of voters, tax policy needs to be designed with the future in mind and ad hoc changes to appease particular interest groups avoided if business and the public are to have confidence in the integrity of the tax system. The need to remain globally competitive both in respect to tax (fiscal) policy and regulatory policy is paramount.

The only other announcement of note in relation to taxation policy is a funding boost of $74m over five years for extra tax compliance, which includes $29m for property tax compliance.

KiwiSaver
We also note that the Government has decided to remove the $1,000 kick-start payment for new KiwiSaver members. KiwiSaver cost the Government $850m this year through both the kick-start and annual subsidy alone, and in total has cost the Government $2.5b since the scheme began. It is expected that the removal of the kick-start element will save the Government $500m over the next four years.

Business innovation
In terms of announcements to assist business directly, there is funding of $12.1m over four years for the establishment and running of the New Zealand Business Number (NZBN), which provides a unique identifier for businesses to use when interacting with Government. BusinessNZ views the NZBN as a key tool in which businesses interact in an efficient manner with Government, and therefore assist in reducing compliance costs.

In the R&D space, there is funding for up to $25m over three years to support the establishment of new, privately-led Regional Research Institutes, along with $80m extra for R&D growth grants.

Other policies
There are a raft of other announcements and funding arrangements in respect to areas from KiwiRail to the funding of biosecurity at the border. Overall though, nothing that would be considered to have any major impact on business.

Concluding thoughts
Notwithstanding the above positives from the Budget, the jury is out as to whether a slowly slowly approach is ideal but given the nature of the political process, large scale reforms are probably a thing of the past. The Government is being careful to try and take the public with them through the reform process but the danger with a gradualist approach is that the world will move on before substantial reforms can be implemented so the Government is always in danger of being in catch-up mode.

Budget 2015 – The Economic Outlook

The Economic Outlook is reasonably sound with key economic indicators heading in the right direction over the forecast period.

Key Points

- **Economic activity** is expected to be modest over the forecast period out to 2019 averaging 2.8% per annum. Projected growth rates are down slightly on earlier forecasts mainly due to lower than expected commodity prices.

- **Inflationary pressures** are expected to remain relatively subdued over the forecast period averaging around 2% per annum out to 2019.

- **Employment growth** is expected to show moderate growth from the current estimated annual growth of 3.3% to around 2% for the out-years to March 2019.

- **Unemployment** is expected to drift lower to reach 4.6% by 2019.

- **Wages pressures** are forecast to be moderate over the forecast period to 2019. Wage growth (as measured by the Quarterly Employment Survey – average hourly ordinary time earnings) is expected to be around 3% per annum.

- The **exchange rate** (as measured by the Trade-weighted Index – TWI) is expected to remain relatively stable over the next few years to reach 77.1 cents by 2019 (down marginally from 77.9 cents currently).

- **Interest rates (90-day bank bills)** are forecast to increase gradually over the forecast period to reach 4.6% by 2019.

Budget 2015 - Fiscal Position

Key Points

- The Government's forecast deficit for 2015 is $684 million (or 0.7% of GDP). The Government's books are now expected to be slightly in surplus next year before surpluses are expected to increase progressively to reach $3.6 billion in 2019.

- **Core Crown expenses** are forecast to reduce slightly from 30.5% of GDP (current) to around 29.2% by 2019.

- **Core Crown revenue** is forecast to increase from around 26.3% of GDP (current) to around 28.2%% by 2019. Current revenue streams have been lower than expected largely due to weaker inflation and lower interest rates.